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Climate Change and Energy: Household and Markets
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Dear Gill

ERA response to Carbon Emissions Reduction Target April 2008 - March 2011

The ERA is pleased to offer the following response to the Carbon Emissions Reduction Target April 2008-March 2011. Overall the consultation shows that the industry has been listened to and the proposals for CERT are to be welcomed.

However, a detailed industry analysis of the available households without insulation that can be realistically and cost effectively improved clearly indicates that Defra has over-estimated the volume of CERT targets that can be achieved. The ERA has serious concerns that the limited flexibility options will not enable suppliers to meet shortfalls in their CERT targets. The consultation paper estimates that there will be 1.3m remaining fillable cavity wall households in the priority group by 2008. The illustrative mix requires 1.3m of those remaining to be filled. It is highly improbable that energy suppliers will achieve 100% coverage and will need to achieve up to 20% of their target in other measures in the priority group.

Summary:

In summary the ERA requests a revision of the proposed targets:

- **25% PG group. - The current proposal for a 40% Priority Group does not achieve financial equity puts at risk efforts to reduce household carbon emissions.**
- **10% cap on innovation - A larger proportion for innovation should be allowed to maximize the opportunities for carbon savings. This is critical if suppliers are to explore the potential for carbon savings from behavioral measures and for CERT to provide experiences that will be important in a transition to a Supplier Obligation post 2011**
- **10% on PG flexibility - In its current form customers that fit the flexibility option are harder to find than the priority group.**

- **A cap on overall spend to mitigate risk**

The ERA is concerned that there is no 'safety net' if suppliers are unable to achieve the challenging targets set under CERT. The CERT scheme has a significant impact on an energy suppliers' bottom line. The penalty for failing the CERT target is severe and suppliers will be investing large sums to resource and deliver CERT. Despite the flexibility options proposed in the revised scheme CERT, remains a high risk target. Currently this risk is carried solely by energy suppliers. In previous discussions the ERA has expressed a need for there to be limits on a supplier's liability. We would welcome clearer indications that this will be given consideration in the final CERT programme.

To resolve this concern, the ERA proposes that a cap is placed on each suppliers spend on CERT, proportionate to the size of their obligation based upon the £2.5bn as provided in the Illustrative Mix of Measures in the consultation paper. This should be regardless of the carbon saving that has been delivered. In the event that costs exceed the indicative level, suppliers would have no further liability to deliver any additional carbon savings.

A cap would limit the crucial impact on household bills, particularly for those on low incomes. Suppliers will always have the commercial incentive to deliver below the indicative cost, so this safety net would only be used in extreme conditions.

- **We agree with the principle but not the estimated costs now the proposed 40% priority group because it is not financially equitable for all consumers.**

The ERA recognises the continued requirement for CERT to be a financially and socially equitable programme. We also note that, according to Defra's Initial Consultation paper only 100,000 households will be lifted out of fuel poverty over the three phases of the programme and, therefore alleviating fuel poverty is not a primary outcome of CERT.

The current proposal for a 40% Priority Group does not achieve financial equity. In particular the indirect costs quoted in the illustrative mix do not take into account the escalating costs associated with the increased difficulty of targeting priority group households over the lifetime of the scheme. Suppliers estimate that indirect costs of the most inexpensive measures will increase 60% between 2008 and 2011.

In addition, the ERA and NIA have already provided detailed analysis of the volumes of work that can be feasibly be achieved in the priority group in the *National Insulation Association/Energy Retail Association Submission on the Size of the Priority Group in EEC3* submitted to Defra in February 2007.

The ERA believes that the consultation provides an opportunity to review the emphasis that has been placed on fuel poverty. EEC and CERT are not effective policy instruments for tackling fuel poverty. Refining a carbon policy instrument to tackle fuel poverty is not the right approach for CERT.

The current priority group target only hits 15% of the fuel poor, with the flexibility element increasing this to an anticipated 50% (for 5% of the target). The ERA has put forward detailed proposals for fuel poverty programmes that would involve significant investment based on savings from the increased cost of a large priority group. However, these cannot be adopted if expenditure is diverted to increased priority group targets and, more recently, to meet demands for subsidised social tariffs.

We believe the options for CERT are to set the priority group at a maximum level of 25% in order to achieve financial equity.

The eligibility criteria for the flexibility option should be widened because, as currently drafted, households that fit the flexibility option are harder to find than the priority group. This appears to contradict the underlying principle of CERT as primarily a social equity programme distinct from a fuel poverty scheme. However, as stated, as long as the scheme meets the carbon targets, a wider range of measures to help the fuel poor should be allowable.

- **Microgeneration market unlikely to be transformed significantly by CERT**

The ERA agrees that CERT should be a pathfinder exercise in preparation for the supplier obligation post 2011, which may include microgeneration as part of an energy services package. There is also an assumption in the consultation paper that microgeneration measures will allow suppliers to meet shortfalls in their carbon savings targets caused by the declining opportunities to install insulation. However, there is no evidence to suggest that the microgeneration market will be transformed by CERT activity or that CERT can fill the gap left when the Low Carbon Buildings Project comes to an end in 2008.

In the priority group, flexibility option biomass boilers and ground source heat pumps are proposed as the most effective microgeneration measures to remove households from fuel poverty. This will not be financially equitable and contradicts Defra's assertion that CERT is a social equity programme not a fuel poverty scheme. As stated, a wider definition of households eligible within the priority flexibility option is necessary to broaden the options for microgeneration to be installed, for example the scheme could be widened to all priority groups and apply to all microgeneration measures.

The ERA also believes that the technology prices are considerably understated in the CERT consultation. For example, ground source heat pumps are quoted at £8.4k. Suppliers' experience of the Low Carbon Building Programme indicates that the cost for a one-off installation with site works is closer to £15k.

Market transformation will be dependent on increased consumer demand and economies of scale. This is not a given, and high cost products will remain the reserve of a niche market unless they are coupled with other fiscal incentives. The current round of funding under the Low Carbon Buildings Programme is too limited to fulfil this function and should be linked with CERT, rather than replaced by it.

The experiences of the insulation industry have provided lessons to be learnt, including the need to establish a level playing field for microgeneration technologies to make them economically comparable with conventional measures in terms of carbon savings per tonne.

- **Indicative costs are too low.**

The ERA believes that Defra's assessment of the cost has been under estimated by some £1bn. This presents a significant risk to suppliers given the level of investment that CERT will incur, and may impact on other investment programmes required by the industry, such as the smart meter roll out.

It may also have the perverse effect of pushing more households into fuel poverty and therefore undermining any improvement for priority group households. We urge Defra to revise the predicted costs taking into account the projected state of the market by 2011.

- **Insulation remains the primary measure by which to achieve the CERT target, but industry capacity is still not proven.**

The effect of an input driven scheme has led once again to a decline in activity in the insulation industry as suppliers have neared completion of EEC2. When combined with the strong reliance on insulation measures in CERT, insulation installers are faced with a significant step change to increase capacity at the start of the carry over period. It has not been possible to resolve the erratic demand caused by seasonality. The insulation industry also risks being unable to meet capacity demand sufficiently. This is particularly the case in the early stages of CERT when some suppliers will be expecting to frontload their activity.

- **Fuel switching volumes are unrealistic**

The current level of EEC-funded fuel switching activity is running at approximately 28,000 jobs per annum. To increase fuel switching activity by 2.5 times in order to achieve an annual switching rate of 70,000 is not considered possible. We have highlighted in a separate paper to Defra the specific difficulties in accrediting carbon savings to fuel switching. The current level of fuel switching as recorded in EEC2 should be used as an accurate proxy to set the likely level of activity during CERT.

- **Combining demonstration and transformation activity within 5% limits opportunities**

The ERA welcomes the introduction of the innovation option. The doubling of the target from EEC2 means that this option becomes a necessity for suppliers and is therefore a very important feature of the illustrative mix. However, a combined total of 5% for both demonstration and market transformation activity places restrictions on the levels of investment. It is not possible to build a business on this percentage that will create the market required post 2011.

By sharing the same 5% cap the uplift on transformation activities could undermine the demonstration activity. For example, suppliers planning to supplement the anticipated shortfall in insulation activity with microgeneration measures will exhaust the 5% on priority on heat pumps (1.3% of CERT target) and wood chip boilers (2.8% of CERT target). In these circumstances Defra's ambitions for demonstration activity on behavioural change or energy services packages would not be realised before 2011.

We are concerned therefore that the CERT innovation option will provide limited practical experience before the initial design of post 2011. A further transitional stage may be required post 2011 with a wider innovation option in which demonstration and market transformation are allocated separate, larger percentages.

In recent discussions with the Housing Minister, energy suppliers considered the possibility of awarding uplift to activity associated with the promotion of Energy Performance Certificates. We would welcome a further detailed assessment of this option as part of the consultation.

- **Administration of the scheme must be kept simple**

A feature of the Energy Efficiency Commitment that has sometimes led to frustration and delay for suppliers has been the complexity of the administration of the scheme. In order to make sound economic business decisions and achieve competitive advantage, suppliers will require support from the administration procedures.

CERT is potentially more complex with ex-ante credits being awarded to innovation measures. The ERA will respond to the Ofgem consultation on the administration procedures. However, it is important for Defra to ensure that CERT is simplified to refocus the scheme on outputs based on overall carbon savings. We look forward to working with Defra and Ofgem to develop an administration procedure that is as responsive as necessary to limit the impact of any associated administrative burdens.

- **Further work needed by Government to drive customer awareness/demand.**

The ERA remains concerned at the low level of attention that has been given to the issue of consumer demand. Products brought to market in EEC1 are still supported by subsidies from suppliers and there is no evidence that consumer demand is linked to consumer awareness. Recent research by Ofgem indicated that consumers are aware of the need to be energy efficient but would only contribute £15 of their energy bill with an expectation that energy suppliers would subsidise the remainder of the cost of energy efficiency measures. In a volatile global energy market this is not sustainable during the period of CERT or crucially beyond 2011.

The proposed energy reduction research trials have yet to be launched and any findings on what generates consumer demand will not be available until the end of the CERT period. Therefore, we would welcome evidence from Government to support the assumptions that suppliers will be able to drive demand.

Therefore, the scale of the targets requires specific support in the form of fiscal incentives for consumers. These should be supplemented by mandatory targets on local authorities. The Nottingham Declaration is a voluntary commitment for UK councils to take action on climate change, launched in October 2000. Over 80 councils have signed up to the Declaration. Signatory councils have found it a useful way of raising the profile of climate change and making their commitment public. The ERA believes that funding should be available to support officers in their work on energy efficiency and climate change as a permanent established function of local authorities.

There is an additional challenge in the rented sector when landlords may be reluctant to incur a capital cost of installing energy efficient equipment when the benefits accrue to tenants. The most efficient way to tackle this would be by promoting and continuing direct landlord incentives such as the Landlord's Energy Saving Allowance as well as considering the possibility of introducing penalties for inaction.

Comments on draft Statutory Instrument

Previously we have raised our objection to the translation factor being stated in the draft Order. Our primary concern is that if the Order is approved in its current form, that there is no option to review the translation in line with the market. It is not realistic to set this in stone for three years when we are uncertain how the price of technology is likely to change over the lifetime of CERT.

Embedding the values for solid wall insulation, ground source heat pumps and biomass boilers within the draft Order means there is no flexibility should market conditions change. The values for these products are based on £ per carbon tonne. The selling price is key for this option to be commercially viable. If the values are set incorrectly at the beginning of the programme and cannot be revised if market conditions deteriorate suppliers are bound to an unviable option and exposed to the associated commercial risk. The ERA believes that these values should be removed or a formula inserted which can be adjusted if the price of the product changes.

The following observations may also assist Defra in finalising the draft Order.

14 3 (c)

- As drafted this would exclude households that have gas but do not use it for heating. We would prefer an amendment to include any property without gas central heating. Social housing should be included along with private households.

Innovation (article 8)

- Current drafting for Market Transformation (4 a,b) implies that qualifying actions can only be claimed if they: a) not claimed in EEC1 **and** b) deliver a 'significantly greater reduction' to a comparable action. This follows the wording of the Order for EEC2. Qualifying actions are eligible under both conditions, but should not be dependant.

Final calculation of reduction in carbon savings (articles 18 – 19)

- We have consistently lobbied for an extension to the notification period at the end of the programme. Without this concession the CERT programme is foreshortened by three months at the end of the programme, which is potentially a productive winter period. This is not conducive with the scale of the CERT target. A fairer and more realistic reporting time frame would be the end of June 2011 for all activity to be notified to Ofgem.

We would be happy to meet with Defra officials for further discussion on any of the points raised in this submission.

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